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ZURICH AMERICAN INSURANCE COMPANY

8 UNITED STATES DISTRICT COURT  
9 CENTRAL DISTRICT OF CALIFORNIA  
10 SOUTHERN DIVISION

11 PACIFIC PREMIER BANCORP,  
12 INC. a Delaware corporation, and  
13 PACIFIC PREMIER BANK, a  
California corporation,

14 Plaintiffs,

15 v.

16 ZURICH AMERICAN INSURANCE  
17 COMPANY, a New York corporation,  
and COLUMBIA CASUALTY  
COMPANY, an Illinois corporation,

18 Defendants.  
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Case No. 8:22-cv-00842-CJC-DFMx

Hon. Cormac J. Carney  
Courtroom 9 B

**DEFENDANT ZURICH AMERICAN  
INSURANCE COMPANY'S REPLY IN  
SUPPORT OF MOTION TO DISMISS  
FIRST AMENDED COMPLAINT  
(Fed. R. Civ. P. 12(b)(6))**

Date: September 26, 2022  
Time: 1:30 p.m.  
Courtroom: 9 B

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Defendant Zurich American Insurance Company (“Zurich” or “Defendant”) respectfully submits this Reply in support of its Motion to Dismiss (Fed. R. Civ. P. 12(b)(6)) the First Amended Complaint of Pacific Premier Bancorp, Inc. (“Bancorp”) and Pacific Premier Bank (the “Bank,” collectively “Plaintiffs”).

## I. INTRODUCTION

Plaintiffs’ lawsuit should be dismissed because the Underlying Actions are excluded in their entirety under the Policy’s Lending Act Exclusion. Nothing in Plaintiffs’ Opposition alters this conclusion. The Bank is a Defendant in the Underlying Actions for a simple reason—because of its lending relationship with the AEI Defendants. By lending money to AEI Defendants, the Bank carried out “Lending Acts” as defined under the Policy.

In their Opposition, Plaintiffs do not dispute that providing credit and loans are “Lending Acts” under the Policy. They do not dispute that Grandpoint Capital Inc.—to which Plaintiffs are the alleged corporate successors—chose *not* to purchase coverage under the Policy for “Lending Acts.” Further, they do not dispute that the Lending Act Exclusion requires only “a *minimal* causal connection or *incidental* relationship” between the alleged “Wrongful Acts” and Lending Acts. Instead, Plaintiffs offer several arguments peripheral to the issues, which are heavy on rhetoric but lacking any supporting authority. These are unavailing.

First, Plaintiffs propose reading the Policy to require that Wrongful Acts must be committed by an “Executive Officer” for the Lending Act Exclusion to apply. However, this depends on a tortured and illogical reading of the Policy. Plaintiffs provide *no* authority in support of its proffered interpretation, and there is none in California or elsewhere. On the contrary, both the plain language of the Policy and available authorities show that no such requirement exists.

Second, Plaintiffs essentially cut-and-paste their assertions from the First Amended Complaint (“FAC”) into their Opposition, averring that certain “Wrongful Acts” alleged in the Underlying Actions supposedly have “no connection” with

1 “Lending Acts” or do not involve the Bank providing loans directly to the  
2 underlying Plaintiffs. However, Plaintiffs fail to show that *any* of the alleged  
3 “Wrongful Acts” lack a causal nexus with Lending Acts. To the contrary, Plaintiffs  
4 have no counter to the essential fact that *all* of the allegations against the Bank in the  
5 Underlying Actions *depend* upon and flow from the Bank’s lending relationship  
6 with AEI Defendants. Indeed, Plaintiffs in the Underlying Actions expressly allege  
7 that the Bank’s loans to the AEI Defendants were “necessary,” “essential,” and  
8 “made possible” the Ponzi scheme, which could not have been perpetrated “but for”  
9 the loans. They further allege that the Bank continued to lend to AEI Defendants  
10 even after it knew that AEI Defendants’ operation was a scam. These allegations  
11 clearly meet California’s “minimal causal connection or incidental relationship”  
12 standard.

13 Third, although the Policy is clear that the “duty to defend” rests with the  
14 insured, in a detour leading nowhere, Plaintiffs assert that Zurich bears this duty. In  
15 fact, the Lending Act Exclusion bars coverage regardless, so the Court need not  
16 reach this issue. Nonetheless, California law is clear that the “duty to defend”  
17 standard does not apply where, as here, the insurer has disclaimed any such duty and  
18 has undertaken only a duty to *advance* defense costs that it determines are covered.

19 As the Lending Act Exclusion bars coverage, the FAC fails to allege  
20 sufficient facts to support Plaintiffs’ claims for breach of contract, declaratory relief,  
21 and “bad faith,” all of which depend on the existence of coverage. Accordingly,  
22 Zurich respectfully requests that the Court grant its Motion and dismisses the FAC  
23 with prejudice.

## 1 II. ARGUMENT

### 2 A. There Is No Requirement that “Wrongful Acts” Must Be 3 Committed by an “Executive Officer” for the Lending Act 4 Exclusion to Apply.

5 In a turnabout from the allegations in their Complaint and FAC that Zurich  
6 “ignore[d] the fact that the operative pleadings ... include allegations of Wrongful  
7 Acts which are separate from ... Lending Acts,” Plaintiffs now oppose Zurich’s  
8 Motion by asserting that, in effect, it is *immaterial* whether the Underlying Actions  
9 include Wrongful Acts in connection with Lending Acts. Compl. 7:21-25; FAC  
10 10:24-11:1. The Bank’s new argument posits that for the Lending Act Exclusion to  
11 apply, the Wrongful Acts can only be committed by an “Executive Officer” as that  
12 term is defined in the Policy. Opp. 9:23-10:2. In short, the Bank attempts to use the  
13 Policy’s severability provision (intended to protect innocent insureds) to fabricate a  
14 new (non-existent) requirement for the Lending Act Exclusion.

15 The Bank’s tortured reading of the Policy ignores the plain language, is  
16 patently unreasonable, and is unsupported in the Opposition by citation to *any*  
17 authority. The provision at issue (the “Severability Provision”) states:

18 For the purpose of determining the applicability of any exclusion set  
19 forth in this Section III, the **Wrongful Act** or knowledge of any  
20 **Insured Person** shall not be imputed to any other **Insured Person**, and  
21 under Insuring Clauses A.3, B, C and D only the **Wrongful Act** or  
22 knowledge of an **Executive Officer** of a **Company** shall be imputed to  
23 such **Company** and its **Subsidiaries**.<sup>1</sup>

24 FAC Ex. 4, p. 56.

25  
26  
27 <sup>1</sup> Imputation between “Insured Persons” is not at issue here because the Bank is not  
28 an “Insured Person”—including only certain “natural persons” and “Independent  
Contractors.” FAC Ex. 4, p. 53 (“Insured Persons”).

1 The plain meaning of this provision is *not* that a “Wrongful Act” by an  
2 “Executive Officer” is a *requirement* for any exclusion to apply. Rather, the  
3 Severability Provision ensures that only allegations against an Executive Officer (as  
4 opposed to, for example, a lower-level employee) can be imputed to the Bank.  
5 However, imputation is wholly irrelevant here, because the allegations in the  
6 Underlying Actions are already *directly* against the Bank.

7 In *Global Fitness Holdings, LLC v. Navigators Management Company, Inc.*,  
8 854 F. App’x 719, 721 (6th Cir. 2021), the Sixth Circuit considered a materially  
9 identical policy provision and squarely rejected the same reading proposed by  
10 Plaintiffs. The issue in that case was whether an exclusion for “liability under any  
11 contract” applied to a class action against the insured gym owners (“Global  
12 Fitness”), which alleged deceptive business practices in the sale of gym  
13 memberships. Affirming summary judgment for the insurer, the court considered  
14 whether the following severability provision prevented the exclusion from applying:

15 [F]or the purpose of determining the applicability of the exclusions,  
16 only the Wrongful Acts of any president, chief executive officer or  
17 chief financial officer of [Global Fitness] shall be imputed to the  
18 Company.

19 *Global Fitness*, 854 F. App’x at 721 (internal quotation marks omitted). The  
20 insured argued that, because only wrongful acts by lower-level employees were at  
21 issue in the class action, the requirement of Wrongful Acts by a “president, chief  
22 executive officer or chief financial officer” had not been met. The court rejected  
23 this argument:

24 [T]o accept this argument we would have to recast the [underlying class  
25 action] as a vicarious-liability suit. The plaintiffs in that case did not  
26 attempt to impute any employee’s wrongful acts to Global Fitness.  
27 Rather, they alleged that Global Fitness engaged in “common polic[es]  
28 and practice[s]” that harmed them by misrepresenting contractual terms

.... The [class action] plaintiffs alleged that Global Fitness *itself harmed them*—not some employee whose actions should be imputed to the company—so the “severability of exclusions” clause does not bar application of the contractual-liability exclusion.

*Id.* (emphasis added).

Ninth Circuit and California case law reinforces that severability provisions serve to protect *innocent* insureds from the conduct of *culpable* insureds. *See J & J Realty Holdings v. Great Am. E & S Ins. Co.*, 839 F. App’x 62, 65 (9th Cir. 2020) (citing *Minkler v. Safeco Ins. Co. of Am.*, 49 Cal. 4th 315 (2010)); *see also Safeco Ins. Co. v. Thomas*, No. 13-CV-0170-AJB, 2013 WL 12123852, at \*5 (S.D. Cal. Nov. 26, 2013) (“[A] lay insured would anticipate that the intentional act of one insured would not, in and of itself, bar liability coverage of another insured....”). A treatise cited by Plaintiffs in the Opposition concurs. *See* HON. H. WALTER CROSKEY (RET.) ET AL., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION § 7:1718 (Aug. 2022 Update) (“Many D&O policies contain a ‘severability’ ... clause stating that the actions of one director or officer ‘will *not* be imputed to any other director or officer’ for the purpose of specified exclusions.”); Opp. 15:14-17.

Here, as in *Global Fitness*, the Underlying Actions do not allege vicarious liability. The allegations in the Underlying Actions are expressly and directly against the Bank, and the Bank *itself* is alleged to have harmed plaintiffs. Indeed, besides other entities and individuals not at issue here, only the Bank is named as a defendant in the Underlying Actions.

In short, the Severability Provision is irrelevant to this case. There is no issue concerning imputation of “Wrongful Acts” by an “Executive Officer” to the Bank because the Bank’s *own conduct* is at issue. Moreover, Plaintiffs have no basis for their argument that the Severability Provision imposes an additional requirement for the Lending Act Exclusion to apply (i.e. allegations against an Executive Officer). Neither the plain language of the Severability Provision nor any case law supports

1 Plaintiffs' effort to avoid the application of the Lending Act Exclusion on this  
2 contrived basis.

3 **B. Plaintiffs' Opposition Fails to Identify Any Facts Falling Outside**  
4 **the Scope of the Lending Act Exclusion.**

5 The entire basis for the Bank's involvement in the Underlying Actions is its  
6 lending relationship with AEI Defendants. The Underlying Actions allege that the  
7 Bank's loans and extensions of credit to AEI Defendants had the effect of propping  
8 up AEI Defendants' Ponzi scheme, in turn allowing the Ponzi scheme to damage the  
9 Pools and their investors. In short, the Underlying Actions plainly allege that the  
10 Bank engaged in "Lending Acts" within the meaning of the Lending Act Exclusion,  
11 which conduct serves as the gravamen for *all* of the allegations against the Bank.

12 Plaintiffs assert in the Opposition that because the Pools' depository accounts  
13 "were not funded by loans from [the Bank]" but by investors, "any alleged  
14 Wrongful Acts ... or resulting damages" are not in connection with a "Lending  
15 Act." Opp. 11:14-19. But how the Pools' accounts were funded is immaterial. The  
16 Bank's lending activities do not have to implicate every aspect of the Ponzi scheme.  
17 For the Lending Act Exclusion to apply, all that is required is that the allegations  
18 against the Bank involve conduct that bears a "minimal causal connection or  
19 incidental relationship" to a "Lending Act." This encompasses both "direct" and  
20 "indirect" connections and requires *less* than "but for" causation. Further, the  
21 injured party need not itself have been the subject of the insured's excluded conduct.  
22 Plaintiffs do not dispute any aspect of the applicable standard as set forth in the  
23 Motion. *See* MTD 17:5-19. Yet, the Underlying Actions could not be clearer in  
24 drawing the connection between the Bank's loan activity with AEI Defendants and  
25 the resulting damages to the Pools and their investors.

1 For example, the Receiver alleges in the Hamstreet Litigation<sup>2</sup> that the  
 2 “Pacific Premier [line of credit] was an *essential* part of AEI Defendants’ misuse of  
 3 Pool assets” and was “an *essential* component to the continuation of the Ponzi  
 4 scheme.” FAC Ex. 1, ¶ 63 (emphasis added). The Receiver further alleges that  
 5 “[t]he Pacific Premier lines of credit to AEI Defendants *made possible* the sales of  
 6 investments in the Pools from no later than June 2008 to the collapse of the Pools in  
 7 2019,” and that “[w]ithout the Bank lines of credit to buffer periods when new  
 8 investor money was not sufficient to make interest payments and distributions ...  
 9 AEI’s insolvency would have been obvious.” *Id.* at ¶¶ 32, 81 (emphasis added).

10 Likewise, plaintiffs in the Anderson Litigation and Beattie Litigation allege  
 11 that the Bank’s “lines of credit to American Equities ... made possible the sales of ...  
 12 securities from no later than June 2008 to the collapse of the [Pools].” FAC Ex. 2, ¶  
 13 65; FAC Ex. 3, ¶ 75. The Bank “provid[ed] credit advances of necessary funding  
 14 secured by receivable contracts taken from the [Pools].” *Id.* Plaintiffs further allege  
 15 that: “*But for* Pacific Premier’s ongoing financing and its cooperation in quietly  
 16 winding down the ... guidance line, the insolvency of American Equities and the  
 17 [Pools] would have been apparent, and American Equities would not have been able  
 18 to continue to sell ... securities after 2008.” FAC Ex. 2, ¶ 19 (emphasis added);  
 19 FAC Ex. 3, ¶ 25 (emphasis added).

20 Thus, it makes no difference that the Bank may not have provided loans to the  
 21 Pools *themselves*. The conduct alleged by the Pools and their investors consists  
 22 entirely of Lending Acts to the benefit of AEI Defendants, who could not have  
 23 perpetrated the Ponzi scheme without the Bank’s assistance. Even if the Lending  
 24 Act Exclusion required but for causation (which it does not) this standard would  
 25 easily be satisfied based on these allegations. There is no serious question that the  
 26

27  
 28 <sup>2</sup> As Plaintiffs note, the Hamstreet Litigation “shares the same operative facts with  
 [the] other Underlying Litigations.” Opp. 11:21-22.

1 lesser standard required—of only a minimal causal connection or incidental  
2 relationship—is satisfied here.<sup>3</sup>

3 Plaintiffs also assert that the Underlying Actions contain “allegations of  
4 wrongful conduct by PPB which is unrelated to any lending activity.”<sup>4</sup> Opp. 2:4-5.  
5 A large portion of this argument repeats *verbatim* allegations in the FAC, already  
6 addressed in the Motion. Opp. 12:5-13:2; *cf.* FAC 4:18-5:11; MTD 21:11-19.  
7 Specifically, Plaintiffs enumerate the same six allegations from the Hamstreet  
8 Litigation that they assert are unrelated to “Lending Acts.” According to Plaintiffs,  
9 each of these depends on the Bank’s awareness, knowledge, concealment, or failure  
10 to detect or disclose the conduct of AEI Defendants (also referred to as the “Pool  
11 Managers”).<sup>5</sup>

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14 <sup>3</sup> Plaintiffs also fail entirely to address the authorities cited in Zurich’s Motion that  
15 found conduct “in connection with” a Lending Act on similar facts. *See Bank of*  
16 *Camilla v. St. Paul Mercury Ins. Co.*, 939 F. Supp. 2d 1299 (M.D. Ga. 2013); *RHBT*  
17 *Fin. Corp. v. St. Paul Mercury Ins. Co.*, No. 0:03-3295-1, 2004 WL 5806112, at \*2-  
\*4 (D.S.C. Aug. 12, 2004).

18 <sup>4</sup> Plaintiffs accuse Zurich of “foisting” the burden onto Plaintiffs of proving the  
19 Lending Act Exclusion does *not* apply. Opp. 14:11-15. Zurich’s Motion does no  
20 such thing. The central argument in Zurich’s Motion is precisely that the Lending  
21 Act Exclusion applies based on the allegations in the Underlying Actions, and  
22 nowhere does Zurich assert that Plaintiffs have failed to show it does *not* apply.  
23 Zurich notes that Plaintiffs have the burden of showing their claim falls “within the  
24 basic scope of coverage.” But this is not the same thing as Plaintiffs having the  
25 burden of showing an exclusion applies. *See Jeff Tracy, Inc. v. U.S. Specialty Ins.*  
26 *Co.*, 636 F. Supp. 2d 995, 1004 (C.D. Cal. 2009) (“[The insured] must establish that  
the underlying claims are within the basic scope of coverage. If [the insured] meets  
its burden, [the insurer] must demonstrate that the claims are specifically  
excluded.”).

27 <sup>5</sup> For example: “[The Bank] ‘was aware of the restrictions on the use of cash  
28 imposed on the Pool Managers as manager of the Pools’ and ‘knew that the Pool  
Managers were violating those restrictions....’” Opp. 12:6-7.

1           However, each of the allegations parsed by Plaintiffs from the Hamstreet  
 2           Litigation is dependent upon the fact that the Bank was aware of, knew, concealed,  
 3           or failed to detect or disclose the conduct *because of its lending relationship with*  
 4           *AEI Defendants and information learned through that relationship*—which  
 5           Plaintiffs simply ignore. The Receiver alleges:

- 6           • “AEI provided Pacific Premier with financial statements in 2008 that  
 7           reflected the scale of its illicit ‘borrowing’ from the Pools....” FAC Ex. 1,  
 8           ¶ 61.
- 9           • “In or around 2008 and 2009, Pacific Premier and AEI agreed to a scheme  
 10          to use Pool assets to allow AEI to pay off [a separate loan with the Bank  
 11          not connected to the Pools]. Despite knowing AEI managed and had  
 12          fiduciary duties to the Pools, Pacific Premier worked with AEI to use  
 13          seven advances on the Pacific Premier LOC totaling \$605,000 to pay off  
 14          the [loan]. Those advances were secured by contracts Pacific Premier  
 15          knew were owned by the Pools.” *Id.* at ¶ 64.
- 16          • “In the spring of 2014, Pacific Premier renewed the Pacific Premier [line  
 17          of credit] for the ninth time. In underwriting the renewal, Pacific Premier  
 18          analyzed ... AEI’s internally prepared financial statements and the overall  
 19          operations of AEI Defendants, including management of the Pools.” *Id.* ¶  
 20          76.
- 21          • “Over the course of several months [in 2015], bank representatives met  
 22          with Miles and ... Pacific Premier did not terminate its relationship or cut  
 23          off funding to AEI .... Instead, it provided extensions on the maturing  
 24          loans until quietly passing them off its books to a financing company  
 25          associated with [Thomas Young, the Bank’s founder].” *Id.* ¶ 79.
- 26          • “Pacific Premier was fully aware of AEI’s precarious financial position, as  
 27          the Miles and Wile candidly discussed it with Pacific Premier.” *Id.* ¶ 59.

1 Plainly, the Bank’s *specific acts* called out in the Opposition did not occur in  
 2 a vacuum. Rather, those acts only occurred in connection with the Bank’s lending  
 3 relationship with AEI Defendants.

4 Lastly, Plaintiffs repeat their argument that Zurich has overlooked “extrinsic  
 5 facts” outside the Lending Act Exclusion. Opp. 1:26-28. However, although the  
 6 Underlying Actions have been pending for *over two and a half years*, Plaintiffs offer  
 7 nothing in support of this assertion except the same discovery response raised in the  
 8 FAC. Plaintiffs claim the Receiver’s denial of a requested admission that the Pools’  
 9 claims against the Bank “[we]re asserted *exclusively* in connection with *credit*  
 10 *advances* made by the Bank to managers of the Pools” is somehow pertinent. *Id.* at  
 11 13:3-6 (emphasis added). It is not. As admitted by Plaintiffs, the Hamstreet  
 12 Litigation involves *both* credit advances and traditional loans. *See id.* 11:22-23  
 13 (“the issuance of loans/extensions of credit and the related servicing thereof”); *see*  
 14 *also* MTD 22:1 n. 9. Thus, the Receiver’s response is merely a statement of the  
 15 obvious—that the Receiver’s claims are not “exclusively” in connection with credit  
 16 advances. As both credit advances and loans are “Lending Acts” as defined, which  
 17 Plaintiffs do not dispute, this is of no moment to the application of the Lending Act  
 18 Exclusion.

19 In sum, the allegations in the Underlying Actions fall squarely within the  
 20 Lending Act Exclusion, which precludes coverage entirely for the Underlying  
 21 Actions.

22 **C. Zurich Is Only Required to Advance Actually Covered Defense**  
 23 **Costs.**

24 Lastly, Plaintiffs spill a great deal of ink in arguing that the Policy implicates  
 25 a “duty to defend” (or that the exact same standard should apply) rather than a duty  
 26 to advance defense costs. *See, e.g., Opp.* 14:28-15:3. This is ultimately immaterial,  
 27 and the Court need not reach this issue because the Lending Act Exclusion  
 28 precludes coverage for the Underlying Actions—and would do so even if Zurich had

a duty to defend. *Itzhaki v. U.S. Liab. Ins. Co.*, 536 F. Supp. 3d 651, 655 (C.D. Cal. 2021) (“Defendants do not owe a duty to defend if any ... exclusions or limitations eliminate *any potential* for coverage.”). Nonetheless, Plaintiffs are simply wrong on this point. The Policy could not be clearer that the *insured* (not Zurich) bears the duty to defend, with the Policy providing as follows in the Declarations:<sup>6</sup>

Item 8. Defense:

A. Management Liability Coverage Part:

☒ Insureds' Duty to Defend ☐ Insurer's Duty to Defend ☐ Not Purchased

B. Non-Indemnifiable Excess DIC Liability Coverage Part:

☐ Insureds' Duty to Defend ☐ Insurer's Duty to Defend ☒ Not Purchased

C. All Other Liability Coverage Parts:

☒ Insureds' Duty to Defend ☐ Insurer's Duty to Defend ☐ Not Purchased

FAC Ex. 4, p. 11.

The duty to defend standard is inapplicable to policies that “clearly and conspicuously” disclaim this duty. *See Jeff Tracy*, 636 F. Supp. 2d at 1003; *Impac Mortg. Holdings Inc. v. Houston Cas. Co.*, No. SACV 11-1845-JST, 2013 WL 4045362, at \*5-\*6 (C.D. Cal. Feb. 26, 2013); *Millennium Laboratories, Inc. v. Allied World Assurance Co.*, No. 12-CV-2280, 2013 WL 12072536, at \*4 (S.D. Cal. July 22, 2013). “Courts applying California law have found that the rules applying to interpreting or establishing a duty to defend are not applicable for a duty to advance

<sup>6</sup> The Policy’s “Defense and Settlement” provision in the Policy likewise provides that the insured has the duty to defend:

1. Insureds’ Duty to Defend

- a. With respect to any **Liability Coverage Part**, if, pursuant to Item 8 of the Declarations, it is the duty of the **Insureds** to defend **Claims**, then, subject to this Subsection VII.A. it shall be the duty of the Insureds and not the duty of the Insurer to defend any Claims and the Insureds will choose defense counsel.

FAC Ex. 4, p. 25.

claims expenses.” *Petersen v. Columbia Cas. Co.*, No. SACV 12-00183, 2012 WL 5316352, at \*9 (C.D. Cal. Aug. 21, 2012); *United Farm Workers of Am. v. Hudson Ins. Co.*, No. 1:18-cv-0134, 2019 WL 1517568, at \*11 (E.D. Cal. Apr. 8, 2019). Absent a duty to defend, the Court need not apply *any legal rule based on this duty*. *Petersen*, 2012 WL 5316352, at \*10 (C.D. Cal. Aug. 21, 2012). Instead, “the action should be evaluated as a normal coverage dispute, more similar to a duty to indemnify.” *Id.* at \*8.<sup>7</sup>

Plaintiffs next assert that the Policy’s allocation provision somehow invalidates Zurich’s clear disclaimer of the duty to defend. Again, a plain reading of the Policy proves Plaintiff wrong. As an initial matter, allocation requires “Loss covered by” the Policy. FAC Ex. 4, p. 23. Here, there is no such Loss, so allocation is irrelevant. In any event, the allocation provision *reinforces* that Zurich need only pay *covered* defense costs. Part B. of the allocation provision, which Plaintiffs omit in their Opposition, provides as follows (in relevant part):

B. If the Insurer and the Insureds cannot agree on an allocation of Defense Costs, the Insurer shall advance on a current basis amounts that the Insurer believes to be covered Defense Costs until a different allocation is negotiated, arbitrated or judicially determined. Any such negotiated, arbitrated or judicially determined allocation shall be applied retroactively to all Defense Costs on account of such Claim, notwithstanding any prior advancement to the contrary. Any allocation or advancement of Defense Costs on account of a Claim shall not apply to the allocation of other Loss on account of such Claim.

*Id.* at 24 (emphasis added).

Thus, Zurich reserves the right to advance only defense costs that it believes “to be covered Defense Costs,” and there is no requirement to advance defense costs

<sup>7</sup> The duty to indemnify is “much narrower” than the duty to defend and an insurer “only has a duty to indemnify the insured for covered claims, and no duty to pay for noncovered claims because the insured did not pay premiums for such coverage.” *Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal. 4th 489, 497, 502-503 (2001); *Axis Surplus Ins. Co. v. Reinoso*, 208 Cal. App. 4th 181, 191 (Ct. App. 2012).

1 where Zurich determines there is no covered Loss. Accordingly, the allocation  
 2 provision is consistent with Zurich's disclaimer of the duty to defend and there is no  
 3 such duty here.<sup>8</sup>

4 Plaintiffs are incorrect that the Zurich policy includes a "duty to defend," but  
 5 even under a duty to defend standard, coverage for the Underlying Actions is  
 6 excluded by the Lending Act Exclusion.

### 7 **III. CONCLUSION**

8 For the reasons set forth in its Motion and this Reply, Zurich respectfully  
 9 requests that the Court dismiss with prejudice Plaintiffs' FAC in its entirety as to  
 10 Zurich, under Federal Rule of Civil Procedure 12(b)(6).

11  
 12  
 13  
 14  
 15  
 16  
 17 <sup>8</sup> The authorities cited by Plaintiffs are inapposite. In *Royalty Carpet*, the provision  
 18 concerning defense costs provided that an outside/third party (not the insurer) would  
 19 determine the allocation between covered and uncovered loss. *Royalty Carpet Mills,*  
 20 *Inc. v. ACE Am. Ins. Co.*, No. SA CV 16-0648-DOC, 2017 WL 4786107, at \*10  
 21 (C.D. Cal. July 17, 2017). Both *Olympic Club* and *Legacy Partners* have already  
 22 been distinguished in the situation where, as here, the policy at issue provides for  
 23 conditional payment of defense costs. *Petersen*, 2012 WL 5316352, at \*9; *see also*  
 24 *Millennium Laboratories*, 2013 WL 12072536, at \*4-\*5. In *Health Net*, the policy at  
 25 issue contained an express duty to defend and the court found that the endorsement  
 26 removing this duty only had the effect of changing the *timing* of payment. *Health*  
 27 *Net, Inc. v. RLI Ins. Co.*, 206 Cal. App. 4th 232, 259 (Ct. App. 2012). In *Braden*  
 28 *Partners*, unlike here, the policy provided that the insurer would *necessarily* advance  
 defense costs for claims "prior to disposition of such claims." *Braden Partners, LP*  
*v. Twin City Fire Ins. Co.*, No. 14-cv-01689-JST, 2017 WL 63019, at \*5 (N.D. Cal.  
 Jan. 5, 2017). Lastly, *Acacia* and *Okada* were not decided under California law. *See*  
*Acacia Research Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. SACV  
 05-501, 2008 WL 4179206, at \*11 (C.D. Cal. Feb. 8, 2008); *Okada v. MGIC Indem.*  
*Corp.*, 823 F.2d 276, 281 (9th Cir. 1986).

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